

## **Explanatory Notes to the Draft Law of Ukraine "On Subsidies and Countervailing Measures"**

With respect to the important role which the Government of Ukraine assigns to Ukraine's joining international economic unions in support of economic development and stability of trade system of Ukraine in conformity with international principles and disciplines, Ukraine's accession to the multilateral trade system GATT/WTO, to the world trade system, and getting away of the status of trade outsider is an integral part of improving of economic reforms and integration processes. One of the conditions of developing of integration processes is the problem of putting Ukrainian legislature in conformity with GATT/WTO normative acts. And according to the requirements of these acts, Agreement on Subsidies and Countervailing Measures in particular, there arises the problem of putting the procedures of state support to enterprises in conformity with the principles and disciplines of GATT/WTO.

The main goal of the draft-law of Ukraine "On Subsidies and Countervailing Measures" is the improvement of procedures of state financial support of enterprises of Ukraine according to the requirements of GATT/WTO Agreement on Subsidies and Countervailing Measures, based on the necessity of improving of export potential and preventing of negative results of protection measures against the subsidized export from Ukraine taken by other countries. Financial support of enterprises in order to improve export potential is one of extremely important aspects of export-import policy of the government especially in the period of reforming of economy towards the market oriented economy with the further goal being the integration to the world economic system.

Currently state financing of Ukrainian enterprises is concentrated in the mining and agricultural industry. In 1995 direct payments to enterprises, excluding direct state investments, amounted to 4.8% of GDP. In 1996 they are planned to be approximately 5% GDP. Proceeding from the necessity of development export potential, which is stated in the Concept of Foreign Economic Policy of Ukraine and in the Program of the Activities of the Cabinet of Ministers of Ukraine in 1995-1996 it is necessary to note that according to the GATT Agreement on Subsidies and Countervailing Measures such a situation on direct state financing of Ukrainian enterprises may result in some negative effects and particularly in taking countervailing measures against the Ukrainian party in the form of countervailing tax of the importing country, which can be imposed on the export- oriented production of Ukrainian enterprises receiving subsidies not abiding to the regulations of the abovementioned Agreement. It is also necessary to note that from the point of economic development subsidies diminish impulses for improving of production efficiency, deteriorate relative prices in Ukraine and thus create false goals for investing which generally deteriorates prospects of economic growth.

WTO Agreement on Subsidies and Countervailing Measures clearly regulates the procedures of granting subsidies in order to prevent such deterioration market situation but at the same time it allows government to interfere with the economy to reach some economic and social results. That is why measures regulating subsidies according to the principles and disciplines of GATT/WTO are aimed at the restriction or banning of subsidies having the most deteriorating effect and at promoting of other types of subsidies for solving of current economic and social problems.

Thus, even not taking into account the fact that regulating of procedures of state financing of enterprises according to the principles and disciplines of GATT/WTO is one of the requirements of this organization in the process of Ukraine's accession to it, in the context of solving the problem of supporting the export potential of Ukrainian enterprises it is necessary to make this step, first of all to avoid spending on countervailing tax payments which can be imposed for Ukrainian exports financed violating the regulations of this organization, and also to protect Ukrainian market from imports financed violating the requirements of GATT/WTO and, thus, to avoid possible negative effects of such imports by imposing countervailing tax on the importing party.

Besides, it is necessary to note that if Ukraine does not implement the appropriate measures on putting procedures of state financing of enterprises in conformity with GATT/WTO requirements there is a threat that such international organizations as IMF, World Bank for Reconstruction and Development, EC can reduce their financial aid due to Ukraine's dependence on imports of energy. These organizations argue that as it was mentioned above subsidies generally influence the economy and in particular they deteriorate impulses for improving of the efficiency of energy industry.

Proceeding from the abovementioned in the process of accession to GATT/WTO and in order to avoid negative effects of the old procedures of state financing it is necessary for Ukraine to put current and future activities on state financing of enterprises in conformity with the principles of WTO and to support the implementation of procedures for protection of national market from imports which are subject to banned subsidies. This Law will facilitate the process of reaching this goal.

**Draft-Law of Ukraine**  
**"On Subsidies and Countervailing Measures"**

This Law regulates procedures of state financing of national enterprises and of protecting national market from subsidized imports which can materially damage interests of Ukraine with respect to the requirements of multilateral trade system GATT/WTO regarding state financing of economy.

**Chapter 1.**  
**General provisions.**

**Article 1. Terminology.**

In this Law the terms are used with the following meaning:

Subsidy - financial investment of the government or any governmental support of incomes or prices which provides some benefit.

Benefit - commercial or financial profit of the recipient of state subsidy.

Financial investment is:

- a) Direct transfer of financial resources or liabilities that is grants, loans, investments of capital;
- b) Potential direct transfer of financial resources or liabilities that is guarantees on loans.
- c) Overdue or uncollected incomes which is a debt to the state that is tax credits, tax reductions, tax privileges and incentives.
- d) State supplies of goods or services.
- e) State procurement of goods.

Specialization of subsidy - situation when subsidy cannot be equally accessed by everybody.

- a) Specialization may appear 'de jure' when in authorities on granting subsidies there are direct restrictions regarding the access to these subsidies of any enterprises or branches or their unions.
- b) Specialization may appear 'de facto' when the requirements for receiving the subsidy are not impartial, are not implemented automatically or are not strictly adhered and also if these criteria are not specified in the regulations or other normative documents.

Harmful activities - activities on support of exports which cause harm to the interests of importing country.

Damage - material damage to the national industry, threat of material damage to the national industry or a considerable delay in creating of the branch in the industry.

Material damage - activities on granting subsidies which lead to ousting or restricting of the exports of another party when exporting to the market of subsidizing country as well as to the market of any third party, or causes considerable reduction of prices, reduction or loss of sales, and also increase of share of subsidized good in the world market.

Countervailing measures - imposing of countervailing tax by the party that has suffered loss in order to compensate the suffered damage.

Countervailing tax - special tax imposed in order to liquidate the results of any subsidy granted for the purpose of stimulating of production, manufacturing or export of any goods.

## **Article 2. Classification of specialization.**

In order to determine the specialization of the subsidy the following principles shall be used within the jurisdiction of the organizations granting subsidies:

- a) Subsidy is classified as specialized in case when the organization granting subsidies or legislation regulating the activities of this organization restricts the access to the subsidy of certain enterprises.
- b) The subsidy is not specialized when the organization granting it or legislation regulating the activities of this organization implements impartial criteria or conditions determining the eligibility and amount of financing under the conditions that the eligibility is automatic and the criteria and conditions are adhered to strictly.

The subsidy is classified as specialized if it is restricted to the certain enterprises which are located in certain geographical region under jurisdiction of organization granting subsidy.

Any subsidy subject to the Article 4 of this Law is classified as specialized.

Specialized subsidy is the reason for imposing countervailing measures by the party that has suffered loss.

Classification of specialized subsidies shall be done on positive evidences.

## **Chapter 2. Classification of subsidies.**

### **Article 3. Types of Subsidies.**

Subsidies are subdivided in the following categories:

- a) Forbidden subsidies.
- b) Non-forbidden subsidies, not subject to the automatic countervailing measures.
- c) Non-forbidden subsidies, subject to the automatic countervailing measures.

### **Article 4. Forbidden subsidies.**

The following subsidies are classified as forbidden (export subsidies):

- a) Direct financing by the government of company or branch, provided for in export indicators.
- b) Procedures for currency saving or other actions of this type which include bonuses for exports.
- c) Internal transport and freight charges on export cargos provided for by the government on conditions more favorable than those on internal cargos.
- d) Provision by the government or governmental agencies directly or indirectly through the programs authorized by them of imported or national products and services for utilization in production of exported goods on conditions more favorable, than just provision of similar or directly competitive products or services for utilization in production of goods for internal consumption, if this conditions are more favorable than those that commercially exist in the world markets for exporters.
- e) Full or partial exemption from or delays in taxation regarding exports for direct taxes or expenditures on social welfare paid or to be paid by industrial or commercial enterprises or for import duties
- f) Allowance for special discounts which directly concern exports or export indicators higher than those

granted for production for internal consumption in respect of taxation practices.

- g) Full or partial exemption for production and distribution of export goods from direct taxes, which exemption is higher than that granted for production and distribution of similar goods for internal consumption.
- h) Full, partial exemption or delay for previous stages of cumulative indirect taxes on products or services utilized in production of export goods, which exemption or delay is higher than that for the similar goods, sold for internal consumption.
- i) Reduction or pay-back of the import duty which is higher than that imposed on imported expenditures in production of exported goods.
- j) Provision from government or governmental controlled special agencies of export credit guarantees or insurance programs, of insurance or guarantee programs against increases of prices for exported goods or provision of programs of currency risks with standards of bonuses which are not sufficient to cover the operation and organization spending of the programs.
- k) Provision from government or governmental controlled special agencies of export credits on conditions more favorable than those they would have to pay for practical use of such financing (or would have to pay if borrowing this assets at the international markets on the same conditions in terms of the same currency as the export credit) or payment made by them of all or part of the expenditures made by exporters or financial institutions in receiving credits, as soon as they were used to provide material advantage in terms of paying on export credits.

Subsidies which depend (as one or more conditions) on utilization in production of national and not imported products are also classified as forbidden.

Government has no right of granting or supporting subsidies classified as forbidden.

#### **Article 5. Damaging Activities.**

Damaging activities include:

- a) Damage to the national industry. The term "national industry" in this law is used for all the national manufacturers of similar goods or for those of them whose total production of these goods makes the major share of total national production of these goods, excluding cases when manufacturers are connected with exporters or importers, or are importers of probably subsidized or similar goods from other countries themselves. In these cases the term "national industry" may be applied to the rest of national manufacturers.
- b) Activities which caused serious damage to the national interests.

#### **Article 6. Material Damage.**

The damage is classified as material if:

- a) Total amount of subsidies in the cost of the subsidized good is more than 5%. Any calculation of the amount of subsidies is to be based on the amount of government spending granting the subsidy.
- b) Subsidies are granted in order to cover operating losses of the branch.
- c) Subsidies are granted in order to cover operating losses of the main activities of the enterprise, excluding the cases when the subsidy is a one-time non-repeating measure which can not be repeated at this enterprise and are aimed at sparing time for development of long-term decisions or at preventing tough social problems.
- d) Direct writing off of the debt, i.e. writing off of the state debt and assignation covering the debt payment.

Material damage can also appear if the effect of subsidy is:

- a) Pushing out or prevention of imports of similar production in the market of subsidizing country.
- b) Pushing out or prevention of exports of similar production in the market of third country.
- c) Considerable price reduction for subsidized products compared to the price of similar products of other party in the same market or considerable holding down of the price increase, price reduction or lost sales in the same market.
- d) Increase of percentage of subsidizing party in the world share on subsidizing products compared to the average percentage this country had in the previous three years and this increase tends to grow while the subsidy is operating.

There is no material damage if the subsidizing country shows that the subsidy did not result in any of the above-mentioned.

#### **Article 7. Subsidies Not Subject to Automatic Countervailing Measures.**

Common subsidies, i.e. those which are not subject to the specialization criterium (non-specialized subsidies) are not subject to automatic countervailing measures.

Specialized subsidies of the following three types are not subject to automatic countervailing measures:

- a) State support to scientific and pre-competitive researches under conditions that subsidy is not higher than 75% of value of scientific researches or 50% of value of pre-competitive researches, or if it is granted exclusively for covering the following spending:
  - (i) expenditures on the stuff dealing exclusively with research activities;
  - (ii) expenditures on tools, instruments, territory and buildings used permanently and exclusively for research activities (excluding sale on business conditions);
  - (iii) expenditures on consultive and similar services used exclusively for research activities, including for purchasing of scientific and technological knowledge, patents and the like;
  - (iv) additional expenditures which are direct results of research activities;
  - (v) other current expenditures (including on materials, logistics and the like) exclusively for research activities;
- b) State programs on granting help to economically depressed regions on one of the following conditions:
  - (i) any such region should have clear compact economic and administrative territory;
  - (ii) region receives the status of economically depressed on objective evidences, which show that regional problems are not just results of temporary conditions; this evidences are to be clearly determined in normative acts and other official documents and accessible for examination;
  - (iii) this evidences have to include analysis of economic development, based on the following indicators:
    - income per capita or per member of family or GDP per capita which is not higher than 85% of the average indicator for this territory;

- level of unemployment which is not less than 110% of the average indicator for this territory, calculated for the last three years.

c) Governmental programs on support of adaptation of enterprises to the new ecological conditions on conditions that this program:

- (i) is a non-repeating measure;
- (ii) provides not more than 20% of expenditures on adaptation;
- (iii) does not cover expenditures on changing and operating the equipment, which are to be totally covered by enterprise;
- (iv) is directly connected and is proportional to the decrease of contamination of environment, planned by enterprise and does not cover economy on production expenses which can be reached;
- (v) is accessible to all enterprises which can adapt new equipment and/or production processes.

#### **Article 8. Subsidies Subject to Automatic Countervailing Measures.**

Selective subsidies, which can not be classified in Articles 4 and 7 of this Law are classified as general subsidies subject to automatic countervailing measures.

### **Chapter 3. Measures on Compensating of Damage.**

#### **Article 9. Calculating of Damage.**

Calculating of damage is based on positive evidences and includes objective examination of the following indicators:

- a) Amount of subsidized imports and influence of subsidized imports on national prices for similar goods.
- b) Influence of subsidized imports on national manufacturers of similar goods.

When determining the threat of material damage it is necessary to take into consideration following factors:

- a) Types of subsidies examined and trade effects of which can result from this.
- b) Considerable rate of growth of subsidized imports in national market which shows the possibility of considerable growth of imports.
- c) Negative influence on the prices of competing national branch and possibility of further growth of demands for imports.
- d) Availability of free or inevitable considerable growth of exporter production facilities which shows the possibility of considerable growth of subsidized exports in the market of importing country, taking into consideration possibilities of other export markets to accept additional exports.
- e) inventory of the goods examined.

None of these factors cannot be decisive one but the set of this factors can serve as the basis for conclusion that it is inevitable to continue to subsidize exports and this may lead to material damage to the interests of importing countries if no countervailing measures are taken.

If export supporting measure is classified as subsidy and it is found to be damaging it is automatically imposed to countervailing measures.

Damage resulting from other economic factors not mentioned in this Article shall not be counted as resulting from subsidized exports and is not subject to countervailing measures.

#### **Article 10. Countervailing Measures.**

Countervailing measures act as a countervailing duty which is imposed on imported goods classified under the Article 8 of this Law only after the procedures provided for in this Law are followed.

Countervailing duty is imposed only after it is finally decided that subsidy took place and the damage resulted from subsidized imports is determined.

Countervailing duty is to be imposed in appropriate amounts on non-discriminatory basis on the imports of goods from all sources classified as subsidized and resulting in damage, excluding imports from sources which denied any subsidy in question.

Countervailing duty imposed on any imported goods is not higher than the amount of existing subsidy.

Countervailing duty is imposed during the time when subsidy is granted and is imposed as long and as much as it is necessary in order to countervail the subsidy resulting in damage.

#### **Chapter 4. Final Provisions.**

#### **Article 11. Conditions of Implementing of Measures Against Subsidized Imports.**

No measures against subsidies of other party can be taken except than in accordance with the legislation of Ukraine.